Linda C. Hunter[1]

Visiting Assistant Professor
San Diego State University

Europe 1992: An Overview

To overcome the economic stagnation and unemployment that characterized the early 1980s, the European Community (EC) has embarked on a unification program. In 1985, Jacques Delors, president of the European Commission, and his fellow commissioners presented a proposal to invigorate the European economy. This *white paper* called for the elimination of internal trade barriers by the end of 1992. Titled "Completing the Internal Market," the white paper sets forth approximately 300 directives to achieve a unified European market. The literature refers to this program as *Europe 1992*.

Although the EC—which consists of Belgium, Britain, Denmark, France, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, and West Germany[2]—is referred to as a *common market*, this term is a misnomer. Within a common market, there are no barriers to the movement of goods or factors of production. Even though all formal tariffs and quotas in trade have been eliminated within the EC, regulatory impediments still obstruct the flow of goods and factors of production. Acceptance of the white paper proposals will ensure the complete mobility of goods and factors of production. If this occurs, then the term *common market* will be more appropriate for the EC.

This article examines the white paper proposals and the effects of the elimination of regulatory barriers on Europe. In an effort to press for acceptance of the entire unification program, the European Commission has not set priorities on the white paper proposals. However, four key measures will contribute to the objective of a unified Europe. These measures are the elimination of border controls, opening of public procurement, harmonization of technical standards and regulations, and liberalization of capital movements and related financial services. Removal of these restrictions to intra-EC trade will eliminate many distortions in the European marketplace.

Although estimates vary considerably, Europe's gains from becoming a unified market are potentially large. Not only will immediate cost-saving benefits result from the removal of regulatory impediments, but also longer-term gains will result from increased competition and firms' exploitation of scale economies. Europe's gains will not be evenly distributed among member countries, however. Most studies suggest that unification will benefit countries on the periphery—such as Portugal, Spain, and Greece—less than those in the interior of Europe, such as West Germany. Analysts have expressed concern that these outlying countries will become discouraged and delay the process of unification.

Proposed elimination of regulatory barriers

Most tariffs and quantitative restrictions within the EC have been eliminated since its formation in 1957, but the Community members continue to operate as individual countries with their own laws and regulations. Consequently, many barriers to

I would like to thank Steve Brown, Bill Gruben, Kent Hill, and Mine Yücel for helpful comments.

[1] *Linda C. Hunter is a former economist at the Federal Reserve Bank of Dallas.*

[2] *The data for this article refer to West Germany before unification with East Germany.*

trade still exist. The white paper contains approximately 300 proposals to eliminate these remaining barriers. Michael Calingaert (1988) has organized the white paper proposals into eight headings.[3]

Border controls. Border controls are clearly the most visible remaining barriers. Even though customs duties are no longer collected at national frontiers, border controls remain because regulations and laws differ across member countries. Border controls ensure that appropriate taxes, which still vary greatly among EC-member nations, are paid to the member countries. Border authorities also enforce health standards on plant and animal products and adjust prices in accordance with the Common Agricultural Policy.

According to a recent survey, businesses consider delays at the border to be the most obstructive barriers they face.[4] Although consumers and travelers also bear the costs of delays at the border in the form of higher prices and inconvenience, delays appear to be a greater burden to companies. Estimates place the cost of delays at borders at almost $10 billion annually.[5]

The white paper's most significant proposal for removing border controls is the introduction of the Single Administrative Document. EC-member nations enacted this measure in January 1988. This document consolidates the many forms member governments have required at their borders. The Single Administrative Document serves as an export declaration, transit document, and import entry statement.

The white paper also proposes the elimination of road haulage permits and quotas that remain between certain member countries.

Movement of people. In general, individuals have complete freedom to move from one member country to another for work, but academic degrees and professional qualifications are not uniformly recognized across countries. Before the white paper was written, EC-member countries negotiated to recognize certain degrees on a profession-by-profession basis. The white paper proposes a general framework for mutual recognition of all degrees and diplomas in all professions.

Legal differences. Each EC-member nation has its own national laws, and this has served as a major impediment to trade within the EC. As a result, the processes of forming joint ventures, establishing mergers across countries, and creating other forms of multinational businesses are much more complicated than if the EC were an integrated market. Intellectual property rights are also handled on a national basis: trademarks and patents are issued by individual countries rather than through a central EC office.

While some measures have been adopted in an effort to harmonize legal differences, there are no provisions for the formation of EC-wide corporations. The one exception to this was the adoption of a regulation in 1985 for European Economic Groupings. This regulation allows firms in different EC countries to join forces on specific projects in a manner analogous to joint ventures. Little progress has been made in the area of intellectual property.

Capital mobility. The term *capital mobility* refers to the integration of financial markets—the free movement of assets across member states. According to the Treaty of Rome, the document that established the EC, all restrictions on capital movements between member countries are to be phased out progressively. The treaty does allow countries to introduce temporary "protective measures" in the event of disturbances in the capital market, such as weaknesses in a currency or underlying problems with economic policies. Progress in deregulating capital movement has been mixed. While some countries allow virtually unrestricted capital movement, others maintain high barriers.

The white paper lists three outcomes from improving capital mobility: increase the effectiveness of financial intermediaries, maintain monetary stability, and improve the allocation of savings. In 1987, in its most dramatic directive passed to date, the Commission submitted a broad package designed to eliminate all controls on capital movements, including short-term monetary instruments, personal bank accounts, and certain types of loans.[6]

[3] *For a detailed summary of the white paper proposals, see Calingaert (1988, 20–27, 38–64).*

[4] *Cecchini (1988, 8).*

[5] *Calingaert (1988, 25).*

[6] *Cooper (1989, 334)*

Indirect taxation schemes. According to the Commission, differences in indirect tax regimes across member countries are among the most difficult obstacles to reaching the 1992 goals. Taxation is one of the few areas that requires unanimous consent among member countries.

The white paper addresses two main forms of indirect taxes: value-added taxes and excise taxes. The Commission has suggested that members agree on minimum indirect tax rates. Members would then be free to set higher rates, if they are willing to accept the consequence that goods will be purchased in areas with lower tax schemes.

Similar concerns have been raised about withholding taxes on interest and dividends. As capital controls are eliminated, individuals will be free to avoid taxes by maintaining their assets in countries with lower tax rates. The Commission proposed a uniform withholding tax. In early 1989, however, Britain and Luxembourg expressed concern about having any withholding by the source country. As a result, this issue remains unresolved.

Services. Even though the service sector has been playing an ever-increasing role in the European economy, both in absolute and relative terms, it remains highly regulated. Trade in financial services has become particularly complicated due to rapid technological change. Because of disparities among regulatory regimes, prices for financial services vary by as much as 50 percent among member countries. As a result, the white paper focuses much attention on this sector. According to a recent EC study, the estimated gain from integration of financial services would be $26 billion.[7]

The Commission has made the following general recommendations for the integration of financial services: deregulation that would allow financial institutions to increase the geographic scope of their operations, harmonization of member governments' standards, mutual recognition of other member government standards, and control and supervision of financial services by the country in which the firm is based for all of its EC operations, including those in other member countries.

Technical regulations. The disparity between technical regulations and standards throughout the EC is high on businesses' lists of intra-EC trade problems. More than 100,000 different industrial standards and regulations currently exist.[8] These differences motivate firms to produce for a narrow domestic market rather than a Europe-wide market. Unless these regulations and standards become more unified, firms will be unable to exploit the economies of scale they need to be competitive in the global marketplace.

The previous system of regulations and standards proved inadequate, so the white paper has proposed a new approach. Only "essential requirements" would be established on an EC-wide level under this approach. These essential requirements cover most regulations, including those addressing health, safety, and consumer and environment protection, and they go a long way toward unifying standards. As long as member countries conform to these requirements, they will be free to establish additional standards of their own.

Public procurement. Although trade in the private sector has expanded greatly over the past 30 years, the public sector has remained very protectionist. In 1987, it was estimated that only about 2 percent of public contracts are awarded to companies in any foreign country.[9]

Nationalistic public procurement policies have created massive inefficiencies. As a result, the white paper proposes more open procedures for awarding contracts to currently excluded markets. The white paper also proposes a legal framework that would allow companies leverage to assert their rights. The Commission has estimated that the savings from opening the public procurement market would total $21 billion.[10]

The proposals suggested by the white paper are quite comprehensive. Despite this, the Commission has made an effort to maintain the program as an inseparable whole. If the European countries were to separate the many proposals into parts, the Commission argues, the integrity of the program would be weakened. Consequently, the Commission has not set priorities on these proposals. Of these proposals, however, four in

---

[7] *Calingaert (1988, 25)*

[8] *Council of Economic Advisers (1990, 251)*

[9] *Calingaert (1988, 26–27)*

[10] *Calingaert (1988, 27)*

particular contribute the most to the objective of a unified Europe: elimination of border controls. opening of public procurement. harmonization of technical standards and regulations. and liberalization of capital movements and related financial services. These four proposals are discussed most often in literature when measuring the gains to European unification.

Conceptualizing the overall gains to Europe

The potential gains to the EC from removing the barriers listed above are derived from three types of cost savings: the immediate benefits from removal of the barriers, the medium-term gains from enabling firms to become more efficient and exploit economies of scale. and the dynamic gains from technological improvements as the economy expands. Studies suggest that the medium-term and dynamic gains are greater than the immediate benefits from integration.

The mechanism through which integration affects a particular industry is as follows. Removal of trade impediments in the industry is a positive supply shock. Dismantling internal barriers reduces costs for European companies trading with other EC countries. The price of the commodity declines as competition increases and firms exploit economies of scale. Competition among firms also increases investment. The declining price of the good increases sales and employment for that industry. Thus, removal of trade impediments causes particular industries to expand. At the same time, other sectors contract as resources shift into the newly liberalized industries.

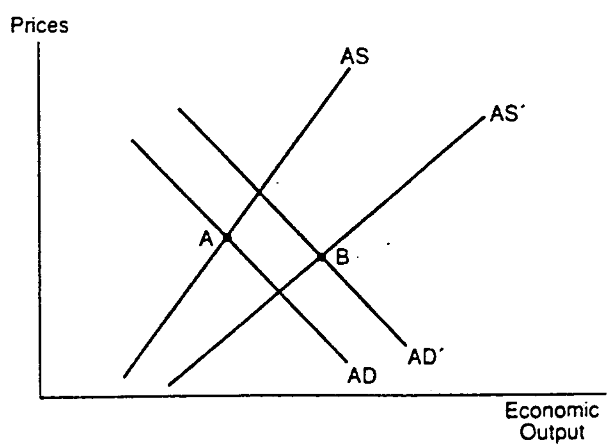
Whether this new pattern of production and trade leads to improvement in global welfare depends on whether unification leads to trade creation or trade diversion. As trade barriers are reduced among EC countries, intra-EC trade will increase. If this increased trade within the EC means that countries purchase more goods from the most efficient producers. then trade creation will have occurred. Trade diversion occurs when changes in regulatory regimes divert trade from more efficient to less efficient producers. This phenomenon may benefit EC producers. but. from a global perspective. it may generate a system of disincentives that reduces world economic welfare.

As an example of trade diversion. suppose that the world's most efficient producer of some good is located in the United States and sells its product to French buyers. Moreover. suppose that a higher-cost producer is located in Italy. but dismantling of intra-EC barriers means that this producer becomes the lowest-price seller to the French. If no trade barriers existed. both within and outside the EC. then the U.S. firm would continue to be the lowest-price producer for the French. The combination of high external EC trade barriers and the removal of intra-EC barriers. however. makes the delivered price to the French buyers lowest for the Italian product.

In this hypothetical example. unification leads to a decrease in global welfare if the loss from switching to the less efficient Italian producer outweighs the gain from removing intra-EC trade barriers. The way in which European unification affects the United States also depends on whether unification results in trade creation or trade diversion (see the box titled "How Will Europe 1992 Affect the United States?").

Figure 1 shows the effects of the dismantling of barriers on aggregate demand and supply.[11] The economy begins at an initial equilibrium point A. Removal of intra-EC trade impediments

Figure 1
The Effects of Unification on European Aggregate Demand and Supply



[11] Dornbusch (1989 344–45)

How Will Europe 1992 Affect the United States?

One of the first questions that Americans ask when considering European unification is, How will this affect us? After all, the United States has a sizeable stake in the European Community. U.S. exports of goods and services to the EC totaled $160 billion in 1989. This figure is almost 50 percent higher than trade with Canada, the largest single-country trading partner for the United States.[1] American firms also have a physical presence in the EC. In 1988, U.S. foreign direct investment in the EC was $127 billion, about 40 percent of all U.S. foreign direct investment.[2]

European unification offers both opportunities and threats to U.S. industry. First, whether the United States benefits or loses depends on whether European unification leads to trade creation or trade diversion for U.S. export goods. It is generally believed that removing internal European barriers will lead to some trade diversion.[3] Emerson, and others (1988) estimate that imports from outside Europe will decrease between 7.9 percent and 10.3 percent.[4] For the United States, this will mean a drop in exports to Europe. If this decrease in European imports falls evenly across all sectors, then U.S. exports should fall between 2.1 percent and 2.7 percent, because U.S. exports to Europe in 1989 were 26.4 percent of all U.S. exports.[5]

Another potentially detrimental effect on the United States will occur if Europe imposes greater external barriers to trade with countries outside the EC. The threat of greater protection is strongest in several specific areas. First is the area of public procurement. Although governments might be willing to open access to public procurement to neighboring EC countries, they may not be willing to do this with countries outside the EC, such as the United States. There may be pressure to award contracts to other European companies rather than to U.S. companies. Thus, contracts that previously would have been awarded to an American firm will be awarded to a company in another member country.

Another area in which protection is likely to increase is health and safety standards. As the EC harmonizes individual country health and safety regulations, standards are bound to increase in some countries. The increasing standards may or may not affect the United States. If it is the case that some goods produced in the United States face already higher domestic health and safety standards, then the increase in European standards will have no effect on the United States. In the case of goods produced according to current lower standards, however, rising standards will increase costs for U.S. firms.

In sectors exhibiting scale economies, increased market concentration could cause plant closings. Communities experiencing new unemployment may invoke pressure on the Commission to increase protection. Although observers fear a "Fortress Europe," no overall pattern of EC behavior toward outside countries has emerged.

Reduced barriers to trade within Europe will benefit U.S. firms conducting business in the EC. Costs to these U.S. firms will decline from the removal of internal barriers, just as costs to European firms will decrease. Be-

(Continued on the next page)

increases aggregate demand as goods within the EC become cheaper. Increased profitability raises investment. Aggregate demand shifts from AD to AD′. Productivity increases as firms exploit economies of scale and become more competitive. Aggregate supply shifts from AS to AS′. The economy moves from the original equilibrium at point A to a new equilibrium at point B. Aggregate output in the economy expands.

Overall, Europe has a great deal to gain by becoming a unified market. Current barriers to trade in the EC distort prices and lead to inefficause defining a product's country of origin is becoming more and more difficult, American subsidiaries in the EC will most likely receive the same treatment as European firms. U.S. firms will be able to use one country as a base and develop an EC-wide network for selling their products, reducing both transportation and capital costs. Conflicting and overlapping regulations will no longer hamper production and trade for U.S. industries in the EC.

Overall, the net effect of Europe 1992 on the United States is still unclear. Much of this outcome depends on how capable U.S. firms are in taking advantage of the increased opportunities that Europe 1992 will offer. A recent article by Robert Lipsey (1990) suggests that large American firms are already well established within Europe. Considerable anecdotal evidence supports this view.

For example, in the car market, although Volkswagen, Fiat, Peugeot, and Renault are all strong in their domestic markets, none has the Europe-wide strength of General Motors or Ford. The same case holds for American computer companies, such as IBM, Digital Equipment, and Unisys.[6] Hewlett-Packard also has more broad-based sales worldwide and within the EC than its European competitors.[7] As Lipsey notes, some U.S. companies are better positioned to take advantage of the unified market than most of their European counterparts.

[1] *Bach (1990.60).*

[2] *Scholl (1989, 46).*

[3] *Cooper (1989, 331), and Dornbusch (1989, 353).*

[4] *Emerson, and others (1988, 238–41).*

[5] *Bach (1990, 48, 60).*

[6] The Economist *(1989c, 74).*

[7] The Economist *(1989b, 57).*

ciencies. Removal of intra-EC barriers increases the demand for European goods. Firms expand their market from a single country to the entire community, allowing them to exploit economies of scale. Greater competition among EC firms causes increased profitability and investment, which increases aggregate supply.

Estimates of the overall gains to Europe

Estimates of the economic expansion in Europe resulting from unification range from as small as 0.5 percent of gross domestic product (GDP) to as large as 35 percent. None of the models estimating the effects of Europe 1992, however, fully consider all related events. All are partial equilibrium models. Accordingly, despite the effort that has been devoted to questions about the impact of Europe 1992, none of it is likely to result in accurate conclusions. Nevertheless, these models offer important perspectives on the process of expansion in the wake of a positive regulatory shock to the multinational economic system.

Among the studies of gains from Europe 1992, the most widely cited was conducted for the Commission under the direction of Paolo Cecchini (1988).[12] The Cecchini report examines the direct gains of the initial supply-side shock from the removal of barriers and the indirect gains from firms' exploitation of scale economies and increased firm efficiency.

To estimate the direct gains, the Cecchini report quantifies the benefits from elimination of

[12] *Emerson and others (1988) provide a detailed description of the Cecchini study*

Table 1
Average Estimated Macroeconomic Gains from European Unification

Barrier	Real GDP	Consumer Prices	Employment (in thousands)
Border Controls	.4	−1.0	200
Public Procurement	.5	−1.4	350
Financial Services	1.5	−1.4	400
Supply-Side Effects	2.1	−2.3	850
Total	4.5	−6.1	1,800

SOURCE: Cecchini (1988), Table 10.1, 98.

border controls, differences in technical standards, public procurement restrictions, and regulations in services. These benefits are calculated using individual industry studies in seven EC countries. These estimates are added together across industries, assuming that the remaining five EC countries will gain in proportion to their GDP. In this sense, these are partial equilibrium estimates because the Cecchini report does not consider changes in relative prices.

Table 1 lists the estimated macroeconomic gains to the EC from elimination of trade barriers. Note that the estimated increase in overall real GDP is 4.5 percent, while prices should decline 6.1 percent. Employment is estimated to increase by 1.8 million. The Cecchini report further examines the benefits from unification in the case of increased government spending. Expansionary fiscal policies would boost real GDP growth up to 7.5 percent, and prices would decline by 4.3 percent.[13]

A more recent study by Richard Baldwin (1989) suggests that the Cecchini report estimates of the increase in GDP are too low. Baldwin argues that the Cecchini report makes no allowance for the dynamic gains from European unification, such as the rise in technological progress due to a permanent increase in the size of the market.

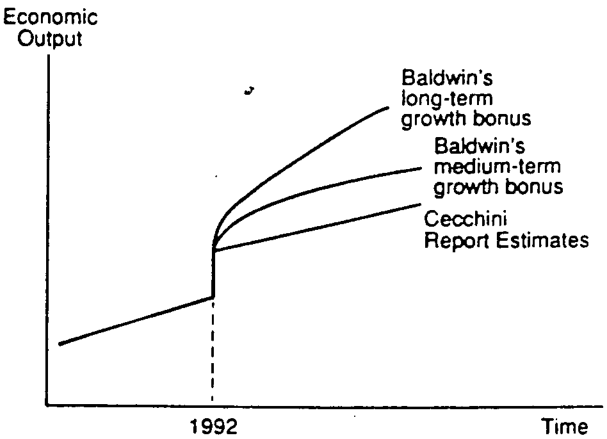
An important difference between these two studies is their treatment of investment and its effects on the capital stock. While Cecchini estimates growth effects for a given capital stock, Baldwin estimates a medium-term growth bonus from the effects of scale economies on a growing capital stock. Baldwin argues that as the scale of economic activity increases, the return to capital rises, creating a greater incentive for investment. Output will rise again, motivating further increases in investment. As the capital stock increases, however, an increasing portion of total investment replaces depreciating capital. Consequently, the economy eventually settles down to a new stable level of capital growth. This medium-term growth bonus is estimated to be between 0.6 percent and 8 percent of GDP.

Baldwin also estimates a long-term growth bonus based on assumptions of a theoretical model by Paul Romer. According to Romer, if the scale effects are large enough, then capital can accumulate indefinitely.[14] An increase in the EC's rate of investment may permanently increase its growth

[13] Cecchini (1988, 100).

[14] In this case, the marginal product of capital does not diminish.

Figure 2
Estimates of the Benefits to Europe from Unification



rate, as shown in Figure 2.[15] Baldwin estimates that this permanent increase in growth will be between 0.3 percent and 0.8 percent. Adding up the output effects, Baldwin concludes that unification will lead to an equivalent one-time increase in GDP of between 11 percent and 35 percent.[16]

Some economists, on the other hand, suggest that Cecchini's growth estimates are actually too large. In a recent study, Merton Peck (1989) argues that the Cecchini report overestimates the increase in output by a factor of two or three. Peck arrives at this conclusion in a rather arbitrary manner, however. Peck compares the hypothesized growth in Europe from the elimination of tariffs on industrial products in 1968, estimated by Dennis Swann (1984), with the current unification effort.

Swann finds that elimination of tariffs on industrial products increased gross national product (GNP) by 1 percent. Peck concludes, rather arbitrarily, that because the proposed changes of the white paper are more extensive, the microeconomic gains should be about 2 percent of GDP. The arbitrariness of Peck's conclusion is even more obvious because Swann's growth estimate is small because trade composed such a minor proportion of the EC's GNP in 1968.[17] International trade has played an increasing role in the EC economy since that time, however. Exports and imports composed about 30 percent of GDP in the EC in 1968 and reached 50 percent by 1989.

The results of a recent study by Data Resources, Inc. (DRI) lend some credibility to Peck's view that the Cecchini estimates are too large. DRI's conclusions are also less favorable than those of the Cecchini report. This study estimates gains in GDP of about 0.5 percent by 1992. According to DRI, employment should increase by 300,000 by 1995, one-sixth the size of the Cecchini estimate. Unfortunately, neither the DRI analysis nor the model that supports it is available to the public because it was prepared for DRI's clients.[18]

Distributional effects within Europe

The gains to Europe from unification—regardless of size—will not be distributed evenly across the EC. Because of regional disparities, some areas will benefit more than others. Some countries may actually lose employment or industries, as individuals and firms move in search of higher paying jobs or proximity to markets. Countries in the periphery of Europe are likely to receive the smallest benefits from European unification, and they may actually lose in some cases. If these countries become discouraged, the process of unification may slow or even stop.

Many different economic variables will determine which areas will be the greatest winners from unification and which areas might incur problems. A recent article in *The Economist* (1990b) ranks the EC-member countries by estimated growth in the 1990s. This ranking includes the effects of Europe 1992, German unification, and economic reforms in Eastern Europe. Table 2 lists the economic variables that will determine the pattern of growth of EC-member countries from Europe 1992.[19] *The Economist* ranking,

[15] The Economist (1989a) provides a nice summary of the Baldwin study and compares his growth estimates with Cecchini's, as shown in Figure 2.

[16] *Baldwin (1989, 265)*

[17] *Swann (1984, 118)*

[18] *This study is described in Cattingaert (1988, 67).*

[19] *Data are available for eleven of the twelve EC-member countries. Luxembourg has been excluded from the table because data were not available.*

Table 2
Variables Affecting Which Member States Will Gain from European Unification

	Hourly Labor Costs	Inflation (percent)	Total Exports	Net Exports of Capital Goods (as a percentage of GDP)	Current Account
West Germany	100.0	2.3	32.6	3.9	5.4
Denmark	81.7	3.0	34.1	.0	–1.1
Netherlands	81.4	2.1	54.8	–1.6	1.9
Belgium	79.3	3.2	69.0	–2.2	2.2
Italy	74.6	5.8	18.1	1.0	–1.4
France	68.1	3.2	21.5	–.3	–.4
Britain	59.5	9.4	23.3	.2	–3.4
Ireland	55.7	4.2	72.0	6.3	1.4
Spain	43.0	7.0	19.5	*	–3.8
Greece	29.1	17.8	24.4	*	4.7
Portugal	18.1	12.8	33.0	*	–3.1

* Net importers

NOTE: These data are the latest available, except the current account, which is a 1990 forecast. The data refer to West Germany before unification with East Germany.

SOURCE: *The Economist* (1990b, 72).

which also takes into account exports to West Germany as a share of total exports and exports to Eastern Europe as a share of total exports, found West Germany to be the greatest winner in the 1990s. Spain will be the country with the lowest growth rates in the 1990s, according to the analysis.

According to *The Economist*, with increased trade and capital flows, investment in labor-intensive industries should rush to areas with the lowest wages. Countries that are net exporters of capital goods, such as West Germany, Ireland, and Italy, are well positioned to take advantage of this increase in investment. On the down side, countries with high inflation rates (Portugal and Greece) and countries with large current account deficits (Greece, Spain, and Britain) may be facing supply constraints. These countries will be less likely to increase production immediately with the expanded marketplace.

A rough tally of Table 2 suggests that the countries least capable of taking advantage of the gains offered from unification are Britain, Greece, Portugal, and Spain—countries located in the periphery of Europe. West Germany stands out as the country likely to benefit most from unification.

One of the critical issues is whether unification will exacerbate currently existing regional disparities.[20] Iain Begg (1990) argues that regional disparities will increase with unification, particularly with respect to labor characteristics. In general, wage rates are lowest in the periphery of Europe. As Table 2 shows, Portugal, Greece, and Spain have the lowest wage rates, while West Germany, Denmark, and the Netherlands have the highest wages in the EC. Wages in Portugal are

[20] See Ca[illegible]gaert (1988, 68–70), Begg (1990), and Bean and others (1990, 14–16) for more detailed discussions of this issue.

less than one-fifth the wages in West Germany. One important reason for these wage disparities is that wages reflect differing skill levels.

Another important reason for the wage disparities is that a combination of demographic pressures and impediments to labor mobility have caused high unemployment rates in the periphery. Wages for a given skill level, therefore, are lower in the periphery than in the core. In the past, migration of unskilled labor has alleviated some, but not all, of this imbalance.

The white paper proposals, however, concentrate on increasing the mobility of skilled labor. Begg argues that the increased mobility of skilled, professional, and managerial workers may cause the peripheral regions to lose skilled labor, increasing the disparity in average skill levels across countries.

Increased firm mobility also affects the distribution of gains from European unification. Begg argues that firms subject to increasing returns to scale will move to countries with larger domestic markets. A pattern will emerge in which firms subject to increasing returns move to central locations, while less dynamic industries remain in the periphery. As the concentration of production and distribution facilities increases in the core, the gains from scale economies and proximity to markets will offset firms' cost of higher wages and congestion.

Begg concludes that the pattern of gains from European unification favor the core regions. This pattern results from the general fact that the past economic performance of the periphery identifies these areas as relatively uncompetitive. Thus, the competitively weak countries will gain the least, and perhaps lose, from EC integration.

Conclusion

The EC has much to gain by becoming a unified market by the end of 1992. The barriers to trade that currently exist in Europe distort markets and lead to inefficiencies in production. By removing these restrictions, the EC has the opportunity to invigorate its economy and improve its position in the world economy.

The removal of intra-EC trade impediments decreases costs directly. As firms expand their markets, they become more competitive and exploit scale economies. Costs decrease further. Declining costs translate into falling prices and increasing demand. Increased profitability raises investment. This stimulates growth and leads to greater investment and further growth.

On the other hand, even though removal of intra-EC trade barriers will lead to greater efficiencies in some markets, it may cause new inefficiencies in other markets. If the EC maintains its high external trade barriers, or perhaps increases them, unification may lead to trade diversion. Countries will switch from purchasing goods from the most efficient producers outside the EC to purchasing these goods from less efficient producers inside the EC. In this case, the removal of intra-EC trade restrictions allow external-EC trade barriers to distort markets.

One question remains unanswered: Will Europe reach its goal and become a unified market by 1992? Of the approximate 300 proposals set forth in the white paper in 1985, the Commission had begun negotiations on 60 percent of them by July 1990.[21] Only 121 of these had been formally adopted at that time. Little progress has been made in the areas of liberalizing the mobility of people and unifying indirect taxation schemes, health standards, and price supports set by the Common Agricultural Policy. These areas will not likely be resolved by the end of 1992.[22]

Europe 1992 is not an event; it is an ongoing process. Although the EC may not meet all the goals set forth in the white paper by the end of 1992, it will have made progress in liberalizing trade. Success in removing barriers will be greater in some areas—the areas with less political friction—than in others. This process of liberalization will continue beyond 1992. Regardless, the European Community of 1992 will be considerably more integrated than that of 1985.

[21] The Economist (1990a, S1–S3).

[22] Cooper (1989, 334–35), and Fieleke (1989, 25).

References

Bach, Christopher L. (1990). "U.S. International Transactions, Fourth Quarter and Year 1989." *Survey of Current Business* 70(3): 33–66.

Baldwin, Richard (1989). "The Growth Effects of 1992." *Economic Policy* 9 (October): 248–81.

Bean, Charles, Edmond Malinvaud, Peter Bernholz, Francesco Giavazzi, and Charles Wyplosz (1990). "Policies for 1992: The Transition and After." *The Macroeconomics of 1992* (Brussels: Center for European Policy Studies).

Begg, Iain (1990). "European Integration and Regional Policy." *Oxford Review of Economic Policy* 5(2): 90–104.

Bennett, Thomas, and Craig Hakkio (1989). "Europe 1992: Implications for U.S. Firms." Federal Reserve Bank of Kansas City *Economic Review*, April, 3–17.

Calingaert, Michael (1988). *The 1992 Challenge from Europe: Development of the European Community's Internal Market* (Washington, D.C.: National Planning Association).

Caves, Richard E., and Ronald W. Jones (1981). *World Trade and Payments* (Boston: Little, Brown and Company): 256–74.

Cecchini, Paolo (1988). *The European Challenge 1992* (Brookfield, Vt.: Grower, Publishing Company).

Chacholiades, Miltiades (1981). *Principles of International Economics* (New York: McGraw–Hill Book Company): 255–73.

Cooper, Richard (1989). "Europe Without Borders." *Brookings Papers on Economic Activity* 2: 325–40.

Council of Economic Advisers (1990). *Economic Report of the President* (Washington, D.C.: U.S. Printing Office): 250–54.

Dornbusch, Rudiger (1989). "Europe 1992: Macroeconomic Implications." *Brookings Papers on Economic Activity* 2: 341–81.

Economist, The (1990a). "A Power in its Own Right." 7 July, S1–S3.

——— (1990b). "Europe's Horn of Plenty." 2 June, 71–72.

——— (1989a). "The Lure of 1992." 18 November, 77.

——— (1989b). "Hewlett–Packard: Safety in Numbers." 12 August, 57.

——— (1989c). "American Firms and Europe: Le Defi is Back." 13 May, 73–74.

Emerson, Michael, Michel Aujean, Michel Catinat, Philippe Goybet, and Alexis Jacquemin (1988). *The Economics of 1992* (Oxford: Oxford University Press).

Fieleke, Norman S. (1989). "Europe in 1992." *New England Economic Review*, May/June, 13–26.

Lipsey, Robert E. (1990). "American Firms Face Europe: 1992." NBER Working Paper Series, No. 3293 (Cambridge, Mass.: National Bureau of Economic Research, March).

Peck, Merton (1989). "Industrial Organization and the Gains from Europe 1992." *Brookings Papers on Economic Activity* 2: 277–99.

Scholl, Russell B. (1989). "The International Investment Position in the United States in 1988." *Survey of Current Business* 69(6): 41–49.

Swann, Dennis (1984). *The Economics of the Common Market* (Markham, Canada: Penguin Books).